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July 27, 2006

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 Holders Of USA Capital First Trust Deed Fund, LLC

**UNITED STATES BANKRUPTCY COURT
 DISTRICT OF NEVADA**

In re:
 USA COMMERCIAL MORTGAGE COMPANY,
 Debtor.

BK-S-06-10725-LBR
 Chapter 11

In re:
 USA CAPITAL REALTY ADVISORS, LLC,
 Debtor.

BK-S-06-10726-LBR
 Chapter 11

In re:
 USA CAPITAL DIVERSIFIED TRUST DEED FUND, LLC,
 Debtor.

BK-S-06-10727-LBR
 Chapter 11

In re:
 USA CAPITAL FIRST TRUST DEED FUND, LLC,
 Debtor.

BK-S-06-10728-LBR
 Chapter 11

In re:
 USA SECURITIES, LLC,
 Debtor.

BK-S-06-10729-LBR
 Chapter 11

Affects

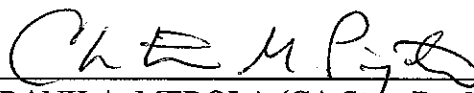
- ☐ All Debtors
☒ USA Commercial Mortgage Co.
☐ USA Securities, LLC
☐ USA Capital Realty Advisors, LLC
☒ USA Capital Diversified Trust Deed
☒ USA First Trust Deed Fund, LLC

Date: August 4, 2006
 Time: 9:30 a.m.

**RESPONSE OF THE OFFICIAL COMMITTEE OF EQUITY SECURITY
 HOLDERS OF USA CAPITAL FIRST TRUST DEED FUND, LLC TO DEBTORS'
 MOTION TO DISTRIBUTE FUNDS AND TO GRANT ORDINARY-COURSE
 RELEASES AND DISTRIBUTE PROCEEDS (AFFECTS DEBTORS USA
 COMMERCIAL MORTGAGE COMPANY, USA CAPITAL FIRST TRUST DEED
 FUND, LLC AND USA CAPITAL DIVERSIFIED TRUST DEED FUND, LLC)**

1 The Official Committee of Equity Security Holders of USA Capital First Trust
 2 Deed Fund, LLC (the "FTDF Committee") appointed in the above-captioned bankruptcy cases
 3 (the "Chapter 11 Cases"), by and through its undersigned counsel, files this response (the
 4 "Response") to the "Debtors' Motion To Distribute Funds And To Grant Ordinary-Course
 5 Releases And Distribute Proceeds" (the "Motion to Distribute")¹ and the "Supplement to Debtors'
 6 Motion to Distribute Funds" (the "Supplement"), filed by USA Commercial Mortgage Company
 7 ("USACM"), USA Capital First Trust Deed Fund, LLC (the "FTDF") and USA Capital
 8 Diversified Trust Deed Fund, LLC ("Diversified" and, together with FTDF, the "Funds"), certain
 9 of the above-captioned debtors and debtors and possession (the "Debtors").

10 This Response is based on the Memorandum of Points and Authorities attached
 11 hereto; the pleadings, papers, and records on file in this action; and any argument to be
 12 entertained at the time of the hearing on the Motion to Distribute.

13 
 14 FRANK A. MEROLA (CA State Bar No. 136934),
 15 EVE H. KARASIK (CA State Bar No. 155356), and
 16 CHRISTINE M. PAJAK (CA State Bar No. 217173),
 17 Members of
 18 STUTMAN, TREISTER & GLATT, P.C.

18 and

19 CANDACE C. CARLYON
 20 SHEA & CARLYON, LTD.

21 COUNSEL FOR THE OFFICIAL COMMITTEE
 22 OF EQUITY SECURITY HOLDERS OF
 23 USA CAPITAL FIRST TRUST DEED FUND, LLC
 24
 25
 26
 27

28 ¹ Terms not otherwise defined herein shall have the same meanings ascribed to them in the Motion to Distribute.

MEMORANDUM OF POINTS AND AUTHORITIES

I.

BACKGROUND

1. On July 7, 2006, the Debtors filed the Motion to Distribute seeking two different types of relief: (i) Court authority to make distributions to investors, including distributions to Fund Members and (ii) Court authority for the Debtors to grant ordinary-course releases and distribute related proceeds.

A. Distributions to Investors.

2. As the Debtors have explained in numerous pleadings filed with the Court, USACM, prior to the Petition Date, made regular monthly payments to investors regardless of whether the underlying loan was performing. As a result, it appears that some investors may have been overpaid.

3. Pursuant to the Motion to Distribute, the Debtors seek Court authority to recover pre-petition overpayments against payments currently due to investors on an investor-by-investor basis, as opposed to a loan-by-loan basis.² Specifically, payments would be offset based on an investor's "vesting name", not by a customer's identification number.³

4. As the Funds, themselves, are direct lenders, their estates would receive distributions to the extent that monies are available after USACM has made the applicable offsets. In addition, the Debtors also request Court authority to make monthly distributions to Fund Members to the extent that monies are available in the respective Fund.

5. While the Motion to Distribute indicates that the Debtors would make an initial distribution followed by subsequent monthly distributions, the FTDF Committee now

² For example, suppose Investor A invested in 2 different loans – Loan #1 and Loan #2. Before the Petition Date, Investor A was overpaid \$50 with respect to Loan #1 and did not receive any overpayments with respect to Loan #2. After the Petition Date, the Debtors still did not collect anything with respect to Loan #1 but collected \$200 on Loan #2. Under the Motion to Distribute, the Debtors are seeking Court authority to pay Investor A \$150.

³ Investors use an investment vehicle – i.e., a "vesting name" – to make investments through USACM. Some investors have multiple vesting names, such as "John Doe" and "John Doe IRA", that are all tied to the same contact name, which the Debtors have tracked by using a customer identification number.

1 understands that the Debtors anticipate modifying their request for relief. The Debtors have
 2 indicated that, after the initial distribution, no subsequent distribution would be made to investors
 3 until a continued hearing is held on subsequent distributions, which would be scheduled for the
 4 August 31, 2006 omnibus hearing date.

5 6. Pursuant to the Supplement, USACM anticipates that the aggregate
 6 amount of the initial distribution is approximately \$64.7 million, which includes a distribution to
 7 FTDF of approximately \$1.8 million. According to the Supplement, after making adjustments
 8 for applicable offsets, no monies would be distributed to Diversified.

9 **B. Request to Grant "Ordinary Course" Releases.**

10 7. The Motion to Distribute also seeks authority to grant partial and full
 11 releases to borrowers and to disburse funds that the Debtors receive in the Collection Account
 12 from loan payment proceeds in connection with the partial release or full release on loans.

13 8. The Debtors set forth a mechanism, by which they would be authorized to
 14 unilaterally grant partial releases to borrowers, which is identical to the procedures set forth in
 15 the Partial Release Order previously entered by this Court, and distribute related proceeds to
 16 investors. The Partial Release Order authorized the Debtors to grant releases on nine specific
 17 loans and, now, the Debtors seek authority to apply these procedures to other loans, as needed,
 18 on a going forward basis.

19 **II.**

20 **ARGUMENT**

21 **A. The FTDF Committee Supports Distributions to Investors, Subject To**
 22 **Adequate Amounts Being Held Back to Pay for Necessary Expenses.**

23 9. The FTDF Committee strongly supports the Debtors' request to distribute
 24 funds to investors. Investors have not received distributions on their investments for several
 25 months, causing great hardship to many. As the Debtors' budget indicates that the Collection
 26 Account now holds over \$90 million, nothing justifies withholding distributions to investors at
 27 this time.
 28

1 10. Distributions to investors, however, should not be made in a vacuum.
2 They should be carefully crafted to take into consideration the many concerns and expenses of
3 these bankruptcy cases.

4 **1. FTDF Committee Supports The Debtors' Request to Offset**
5 **Pre-Petition Overpayments Against Payments Currently Due**
6 **To Investors On An Investor-By-Investor Basis.**

7 11. As this Court is aware, it appears that many investors were overpaid prior
8 to the Petition Date. It makes little sense for USACM to make distributions to investors who
9 owe an obligation back to the Debtors' estates. Allowing distributions to go forward without
10 making offsets on an investor-by-investor basis would likely result in a myriad of lawsuits.
11 Despite receiving a larger distribution, individual investors would now face the additional
12 expense of hiring counsel to defend their interests in numerous lawsuits. Moreover, this
13 litigation would likely involve the pursuit of pre-judgment attachments against investors to
14 ensure that sufficient funds are available to satisfy any resulting judgment. Thus, the practical
15 effect of not allowing offsets for overpayments could have a very real and detrimental economic
16 impact on investors and may result in little, if any, funds being retained by investors.

17 12. Offsetting on an investor-by-investor basis ensures that USACM will be
18 able to recover a larger amount of overpayments, as opposed to offsetting on a "loan-by-loan"
19 basis, and would minimize investors' risk of being sued.

20 13. The FTDF Committee also supports offsetting by an investor's vesting
21 name as opposed to an investor's client identification number. An investor makes investments
22 through its vesting name – i.e., "John Doe" or "John Doe IRA". The Debtors, however, group
23 investors by their contact information under a client identification number. In other words, if
24 different vesting names all have the same contact information, such names would be grouped
25 under one client identification number. While offsets might be legally appropriate across some
26 vesting names, this may not be the case across other vesting names.

27 14. The FTDF Committee understands that offsetting overpayments based on
28 a customer identification number, not vesting name, would result in the Debtors retaining a
maximum amount of \$3 million. Given this relatively small figure and taking into consideration

1 that there are likely legally separate entities among the vesting names that could not be included
 2 in the offsets (thereby reducing the \$3 million figure) as well as the time and expense of
 3 determining whether offsets can be legally made across different vesting names, the FTDF
 4 Committee supports the Debtors' method of offsetting by vesting name, on an investor-by-
 5 investor basis.

6
 7 **2. The Debtors Should Make Appropriate Holdbacks Before
 Distributing Funds to Investors.**

8 15. As currently contemplated, distributions will be made without regard as to
 9 how USACM will pay for the fees and expenses it has incurred in maximizing the value of loans
 10 that it services on behalf of the Direct Lenders. Under the standard loan servicing agreement,
 11 USACM is entitled to seek from each Direct Lender its pro rata share of "attorney's fees, trustee's
 12 fees and the foreclosure costs" and may holdback payments on investors' loans until such
 13 payments have been made. See Loan Servicing Agreement, § 4. In other words, Direct Lenders
 14 are contractually obligated to pay for all appraisals and collection costs, including attorney fees.
 15 In addition, USACM should also hold back the appropriate amount to cover the costs of its
 16 administration of these bankruptcy cases, including fees and costs incurred by counsel for the
 17 Direct Lender Committee

18 16. While, at this time, no determination is being made as to whether these
 19 expenses will ultimately be shared by the Direct Lenders on a pro rata basis, it is appropriate, in
 20 connection with an interim distribution, to withhold these amounts to ensure that such a "fair
 21 share" allocation is not precluded, as a practical matter, by making distributions to investors.

22
 23 **3. The FTDF Committee Supports Distributions to Fund
 Investors.**

24 17. The FTDF Committee joins the Debtors' request to make distributions to
 25 Fund Members. As explained in the Motion to Distribute, this Court has the authority to order
 26 distributions to Fund Members prior to plan confirmation. See Motion to Distribute, p. 12-14.

27 18. As this Court is aware, this is not a typical bankruptcy case. Thousands of
 28 individuals have been adversely affected. As the Debtors stressed in their Motion to Distribute:

it would be inequitable for the Debtors to make distributions to some, not all, investors. As the Debtors have repeatedly emphasized, it is their goal to pay investors – all investors, not just the Direct Lenders. If only Direct Lenders receive distributions from the Collection Account but money is not also released from the Funds to the Fund Members, the approximately 3,200 Fund Members will be adversely affected. The Fund Members, like their Direct Lender counterparts, rely and depend on their monthly distribution they expect to receive from the Funds. It is now over four months since Fund Members have received a distribution, and many are now suffering the consequences of losing their only source of income. To the extent the Funds will hold excess cash, there is simply no reason why these monies should not be made available to the Fund Members.

Motion to Distribute, p. 13 (lines 15-24).

19. In fact, the Debtors anticipate making an approximate \$1.8 million distribution to FTDF. With a holdback of \$800,000 (i) to cover the fees and expenses of the FTDF Committee professionals through the end of June 30, 2006 and (ii) to establish a reserve for the current amount of outstanding pre-petition claims⁴, the FTDF Committee expects that about \$1 million will be available for distributions to FTDF Members.

4. The FTDF Committee Supports Continuing Monthly Distributions.

20. The FTDF Committee also supports the Debtors' request to make ongoing monthly distributions to investors, subject to the Debtors withholding the appropriate amounts as described above. The Debtors have completed their forensic accounting and now have accurate records. Nothing should prevent ongoing distributions to investors. Moreover, it is critical that investors, who have come to rely on monthly distributions, receive those distributions in a timely manner, subject to the appropriate holdbacks.

⁴ According to FTDF's schedule of assets and liabilities, FTDF has \$226,000 in unsecured claims (which the FTDF Committee reserves its right to contest). In addition, approximately 27 claims have been filed against FTDF. The FTDF Committee will shortly be filing an objection to the vast majority of these claims and scheduling a hearing on such objection for August 31, 2006, which, if sustained, would result in only \$25,000 in additional unsecured (non-scheduled) claims being asserted against the FTDF estate.

1 21. The FTDF Committee, however, has no objection to the Debtors' proposal
2 to bifurcate the relief requested in the Motion to Distribute so as to go forward on the initial
3 distribution portion on August 4, 2006 and continuing the hearing on subsequent, monthly
4 distributions until August 31, 2006. In fact, continuing the hearing on ongoing distributions
5 should not affect future distributions as the hearing would be held prior to the Debtors making its
6 next monthly distribution (should the Court approve ongoing distributions).

7 22. In sum, the FTDF Committee supports the relief requested in the Debtors'
8 Motion to Distribute but urges the Court to require the Debtors to hold back sufficient funds to
9 be distributed to cover the costs that USACM has incurred for (i) appraisals and (ii) collection
10 costs as well as a fair share of the costs incurred in administering these bankruptcy cases.

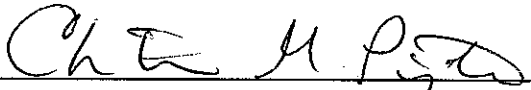
11 **B. The FTDF Committee Supports the Debtors' Request to Grant**
12 **“Ordinary Course” Releases and Distribute Proceeds, Subject to the**
13 **Debtors Applying Holdbacks to Any Such Distributions.**

14 23. As noted above, the Debtors seek authority to grant ordinary-course
15 releases and distribute related proceeds. With respect to granting "ordinary-course" releases, the
16 Debtors' proposed mechanism is identical to the relief granted in the Partial Releases Order. As
17 the FTDF Committee supported the Partial Releases Order, the FTDF Committee does not
18 oppose the Debtors' request to grant ordinary-course partial and full releases as set forth in the
19 Motion to Distribute.

20 24. With respect to the Debtors' request to distribute proceeds that they
21 receive in connection with granting such releases to borrowers, the FTDF Committee believes
22 that any such distributions should also be subject to the holdbacks as described above.
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1 For the reasons stated above, the FTDF Committee supports (i) the Debtors
2 making distributions to investors, including the Fund Members, as set forth in the Motion to
3 Distribute but urges the Court to require the Debtors to hold back sufficient funds to be
4 distributed to cover the costs that USACM has incurred for (a) appraisals and (b) collection costs
5 as well as the fair share of the costs incurred in administering these bankruptcy cases; and (ii) the
6 Debtors' proposed mechanism to grant ordinary-course releases and distribute related proceeds,
7 provided that any such distributions of proceeds are also subject to holdbacks as set forth herein.

8
9 Respectfully submitted this 27th day of July, 2006.

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11 
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